TaxTalk

TAX CONSEQUENCES FOR NON-RESIDENTS IN CANADA

A non-resident of Canada is liable for Canadian income tax for a taxation year under the Income Tax Act (Canada) if the non-resident, at any time in that year

i. Carried on a business in Canada,
ii. Was employed in Canada, or
iii. Disposed of a taxable Canadian property.

If the non-resident earns employment income or business income in Canada, they might qualify for tax exemptions that can modify or reduce income tax under a tax treaty between Canada and their country of residence and as a result be exempt from Canadian tax if specific conditions are met.

Regardless of whether a non-resident is ultimately exempt from Canadian income tax, payments to a non-resident may be subject to Canadian withholding tax.

CARRYING ON BUSINESS IN CANADA

"Carrying on business" is a broad concept and the threshold is fairly low. Determining if the business is carried on in Canada requires analysis of the following key factors. Determination of the place where:

- Contracts are made
- Services are performed
- Profits are earned
- Business premises are located
- Business assets are located
- Employees are located

A non-resident taxpayer that carries on business in Canada is liable for Canadian tax only if it is attributable to income earned in Canada.

However, if the non-resident qualifies for benefits of a tax treaty, the taxpayer's business profits are only taxable to the extent that they are attributable to a Permanent Establishment ("PE") situated in Canada.

As per tax treaties with various countries, generally the following constitute a PE in Canada:

- A fixed place of business such as a place of management, office, branch, factory, or a workshop.
- If an employee or dependent agent has the authority to conclude contracts in the name of the corporation.
- If the activities of the corporation constitute a building site or construction or installation project for a duration exceeding 12 months.

Additionally, there are two mutually exclusive 'cross-border service provider' rules contained in the Canada-US Tax treaty which may deem a PE to exist in Canada for a US corporation that renders services in Canada.

i. The first test would deem a PE in Canada to exist if an individual who is present in Canada for at least 183 days in any 12-month period and during that period more than 50% of the corporation's total revenue is derived from the services performed in Canada by that individual.
ii. If the corporation provides services in Canada for at least 183 days in any 12-month period with respect to the same or connected customers who are either residents of Canada or who maintain a PE in Canada.

Non-resident corporations carrying on business in Canada through a PE situated in Canada will be subject to Canadian federal and provincial income tax on profits derived from the Canadian PE in addition to the "Branch Tax".

Subject to treaty exemptions, Branch Tax is 25% (reduced to 5% for US business') of after-tax income that is not reinvested in the Canadian operations. This is generally intended to approximate the Canadian withholding taxes that would have been payable to the Canada Revenue Agency ("CRA") on dividends paid by a Canadian resident subsidiary to its non-resident parent.

A non-resident corporation that carries on business in Canada in a taxation year must file a return for the year, regardless of whether it has realized a profit in Canada or if its income is exempt from Canadian tax because it qualifies for exemptions under a tax treaty. The exemption is claimed as part of filing the Canadian corporate tax return.

A non-resident corporation that carries on business in Canada in a taxation year, without a PE, should file a nil tax return referred to as a "treaty based" return. Failure do so may result in a penalty of $2,500 per year if the CRA requests the non-resident corporation to file a tax return.

A non-resident corporation that carries on business in Canada may also be required to register for Canadian and provincial sales tax depending on what is sold and to whom the sales are made. Sales tax considerations are beyond the scope of this TaxTalk discussion, and will be addressed in a subsequent TaxTalk.

WITHHOLDING TAX FOR SERVICES RENDERED IN CANADA (REGULATION 105)

For every payor (resident or non-resident), there is a broad withholding and remittance obligation to CRA of 15% of the amount of payment to a non-resident person or corporation of a fee, commission or other amount (other than salary or wages) for services rendered in Canada.

Canadian courts have held that Regulation 105 applies even in a case where the services are performed in Canada by a subcontractor of a non-resident.

In specific cases where multiple service providers are involved, structuring is possible in order to avoid Regulation 105 withholding requirements.

This withholding requirement for the payor applies even when the non-resident corporation does not have PE situated in Canada. The withholding and reporting requirements are as follows:

- Payors are required to withhold and remit the amount withheld to CRA by the 15th day of the month following the month in which amount was paid.
- Payors must issue a T4A-NR slip to each non-resident by March 31st of the following year.

The amount withheld and remitted is not the final Canadian tax liability for the non-resident. Upon filing of the annual Canadian income tax return, the non-resident can recover the withheld tax as per T4A-NR slip if it qualifies for an exemption under a tax treaty with Canada. Failure to file a tax return within 3 years of withholding will result in a loss of any refunds.

Waivers:

The following two Regulation 105 withholding waivers can be filed:

i. Treaty-based waiver: If the non-resident is able to establish entitlement to treaty benefits, a waiver can be filed to relieve the payer from withholding obligations on payments made to the non-resident.

ii. Income and expense waiver: Although slightly difficult to obtain, this waiver allows withholding based on estimated income and expenses for the project. The withholding would still be 15% on the estimated net income.

These waivers must be completed and approved by CRA for each contract prior to receiving payment for both waivers mentioned above.

Note that obtaining a Regulation 105 waiver does not change the filing requirements for both payer and payee.

EMPLOYED IN CANADA

To be employed in Canada includes any work activity a worker is paid to perform in Canada.
Pay includes money or commissions:

- an employer pays the worker,
- the worker receives for services provided, or
- the worker receives for any other activities.

WITHHOLDING TAX FOR NON-RESIDENT EMPLOYEES PAID FOR RENDERING SERVICES IN CANADA (REGULATION 102)

For every employer there are payroll remittance obligations for payments to their employees for employment services performed in Canada. These payroll obligations apply both resident and non-resident employers for both resident and non-resident employees providing services in Canada.

Regulation 102 withholding applies to all types of employee remuneration, including benefits such as stock options.

The withholding and reporting requirement are as follows:

- Employers are required to withhold and remit the payroll withholdings (income tax, Canada pension plan (“CPP”) and employment insurance (“EI”)) to CRA by the 15th day of the month following the month in which amount was paid.
- Employers must issue a T4 slip to each employee by February 28th of the following year.

Regulation 102 withholding does not represent a final tax liability. Employees will need to file Canadian personal income tax returns and any excess tax can be recovered (e.g. there is entitlement to treaty benefits).

Waivers:

i. A waiver from Regulation 102 withholding tax for employment duties performed in Canada may be requested when the employee qualifies for benefits under a tax treaty.
ii. A waiver from CPP and EI may be possible if the employee continues to make social security payments in their country of residence.

WITHHOLDING TAX ON PASSIVE INCOME EARNED BY NON-RESIDENTS

This is a withholding and remittance obligation to CRA for Canadian resident payors on payments to non-residents on certain types of passive income (dividends, rents, royalties, management fees). The withholding tax is 25% of the gross amount paid or credited to the non-resident. This percentage is subject to reduction or elimination pursuant to a tax treaty.

For example, the Canada-US Tax treaty specifies a withholding tax rate of 5% on dividends paid to a corporation resident in the US which owns 10% of the Canadian entity’s voting shares. In all other cases, the withholding tax rate on dividends is 15%. The onus is on the payor to verify treaty entitlement before withholding at a reduced rate from payments to non-residents.

Note that Part XIII withholding tax does not apply to amounts paid or credited to a non-resident if amounts are attributable to a business carried on by the non-resident through a qualifying PE situated in Canada.

The withholding and reporting requirements for the Canadian resident payer are as follows:

- Payors are required to withhold and remit the Part XIII tax withheld to CRA by the 15th day of the month following the month in which amount was paid.
- Payers must issue a NR4 slip to each non-resident by March 31st of the following year.

Withholding tax is a final tax for non-resident, therefore, there is no requirement to a file a Canadian tax return.

Both Canadian resident payers and non-resident recipients are liable for amounts not withheld or remitted, subject to interest and penalties.

In the event that a payment was subject to treaty benefits, the non-resident can apply to the CRA to obtain a refund of the excess tax withheld.

WE CAN HELP

Your MG advisor can help you review your personal or business tax situation and help you decide which steps you should take next.

A memorandum of this nature cannot be all-encompassing and is not intended to replace professional advice. Its purpose is to highlight tax planning possibilities and identify areas of possible concern. Anyone wishing to discuss the contents or to make any comments or suggestions about this TaxTalk is invited to contact one of our offices.

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